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January 30, 2008

VIA ECFS

Marlene H. Dortch
Secretary
Federal Communications Commission
Washington, DC 20554

Re: Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25

Dear Ms. Dortch:

This responds to the January 15, 2008 letter from AT&T in this proceeding.[1]

AT&T assumes incorrectly that interim relief in this proceeding would be implemented as a prescription of rates under Section 205 of the Act. Under its rulemaking authority, as it has done previously, the Commission may establish rules that govern how price cap ILECs set prices on an interim basis without a Section 205 rate prescription.

For example, in the *CALLS Order,* the Commission mandated that price cap LECs comply with certain rate structure components of the CALLS Plan on a mandatory basis and that they set rate levels on an interim basis (1) according to the CALLS plan or (2) set prices based on forward looking cost. The Commission stated that "[p]rice cap LECs will be able to choose between having these interim rate-level components apply for the full five years or having their rates reinitialized on forward-looking economic cost."[2] In this proceeding, the Commission anticipated that it would adopt a plan requiring BOCs to set prices on an interim basis.[3] AT&T's assertion that the Commission may not require

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1 Letter from Gary L. Phillips, AT&T to Marlene H. Dortch, WC Docket No. 05-25, January 15, 2008.

2 *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000)("*CALLS Order*") (subsequent history omitted) ¶ 29.

3 *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and

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price cap LECs to set lower interim prices pursuant to a revised price cap plan or based on forward-looking cost is refuted by the *CALLS Order* and the *Special Access NPRM* in this proceeding.

The Commission could implement a similar approach in this proceeding. As in the *Calls Order*, the Commission could permit price cap LECs to choose to set prices at either forward-looking cost or pursuant to modified price cap rules governing prices on an interim or permanent basis.[4]

Contrary to AT&T's contention, any approach governing interim prices need not include a definitive analysis of LEC productivity merely because it incorporates an X-Factor. The *CALLS Order* included an X-Factor for interstate special access even though it had nothing to do with productivity. The Commission stated:

> By adopting the reasonable approach set forth in the CALLS Proposal, which treats the X-Factor not as a productivity estimate but as a method to reduce rates to certain levels, we expect to end the debate over the appropriate size of the X-Factor now and for the next five years for participating price cap LECs.

Again, the Commission may take the same approach here. If a price cap LEC does not want to adjust prices according to an X-Factor, it may establish just and reasonable prices based on forward-looking cost.

Forward-looking costs remain the benchmark for reasonable access prices. The Commission has previously concluded that "access charges should ultimately reflect rates that would exist in a competitive market" and that in a competitive market rates should reflect forward-looking economic costs.[5] Rates should not be established based on historical accounting costs, *i.e.*, embedded costs[6] because "forward-looking costs are

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(Footnote continued...)

Notice of Proposed Rulemaking, 20 FCC Rcd 1994, FCC 05-18 (rel. Jan. 31, 2005) ¶ 131.

4 The undersigned competitive carriers take no position in this letter on the merits of the various proposals for interim relief.

5 *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982 (1997) ("*Access Charge Reform Order*")(subsequent history omitted) ¶¶ 42 -43, 48.

6 *Alenco Communications Co. v. FCC*, 201 F.3d 608, 615 (5th Cir. 2000) ("rates must be based not on *historical, booked costs*, but rather on *forward-looking, economic costs*. After all, market prices respond to current costs; historical investments, by contrast, are sunk and thus ignored").

generally viewed as more relevant to setting prices in a competitive market."[7] The Commission's judgment in the *Access Charge Reform Order* was that long before now competition would have reduced special access prices to forward looking cost.[8] Nevertheless, it reserved "the right to adjust rates in the future to bring them into line with forward-looking costs."[9] The CALLS Plan was to provide a transition towards achieving the goal of forward-looking cost prices for access charges.[10]

The Commission need not to be concerned about the allegedly "formidable barriers" to setting prices based on forward-looking cost such as the appropriate cost-setting methodology and its relationship to TELRIC. Price cap ILECs will never choose to set prices based on forward-looking cost. As with the CALLS Plan, price cap ILECs will choose an alternative that retains prices that are above-forward looking cost -- whether or not those prices involve substantial reductions from current price levels. Even if a price cap ILEC did choose to set prices based on forward looking cost, however, it would not be a formidable task for the Commission to set prices on that basis because the Commission could build on both FCC and state experience employing TELRIC. Even if, as AT&T states, that TELRIC has some flaws, it has been widely utilized and is well documented.

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[7] *Special Access NPRM*, ¶ 65 (explaining that "[e]mbedded costs are associated with past business decisions and generally are irrelevant to a rational profit-maximizing firm operating in a competitive market; only forward-looking costs matter to such a firm with regard to business decisions that it is required to make today.") (citing *See* Alfred E. Kahn, Timothy J. Tardiff, & Dennis L. Weisman, *The Telecommunications Act at Three Years: An Economic Evaluation of Its Implementation by the Federal Communications Commission*, 11 INFO. AND ECON. POLICY 319, 324-25 (1999) ("Among economists, there is widespread agreement in principle that (1) the costs that would be the basis for efficient prices would be forward-looking, rather than historical and (2) the prices set on that basis should emulate the ones that would emerge from local exchange competition, if it were feasible."); Armen A. Alchian & William R. Allen, EXCHANGE AND PRODUCTION 222 (3d ed. 1983) ("Once [an item] is acquired, [its costs are] irrelevant to the setting of price in competitive markets."); N. Gregory Mankiw, PRINCIPLES OF ECONOMICS 291 (1997) ("The irrelevance of sunk costs explains how real businesses make decisions."); Paul A. Samuelson & William D. Nordhaus, ECONOMICS 167, (16th ed. 1998)).

[8] *Access Charge Reform Order*, ¶¶ 42, 44, 48, 263-265.

[9] *Access Charge Reform Order*, ¶ 48; see also *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, CC Doc Nos. 96-262 & 94-1, Order, FCC 02-161, ¶ 13 (2002).

[10] Special *Access NPRM* ¶ 7.

The GAO has found that "prices and average revenues are higher, on average, in phase II MSAs--where competition is theoretically more vigorous--than they are in phase I MSAs or in areas where prices are still constrained by the price cap."[11] The only reason that AT&T's Phase II prices are at or below price cap prices is apparently because it was required by the AT&T/BellSouth merger conditions to reduce its Phase II prices to price cap levels.[12] Where BOC Phase II prices are above price cap levels, AT&T offers only the vacuous justification that since Phase II prices are established in areas that the Commission's rules identify as competitive, the prices are more "correct" even if they are higher than price cap prices.[13] This is completely contrary to experience in truly competitive markets. Further, BOCs' claims that special access prices have declined rest not on price studies but on average revenues per voice grade equivalent line[14] which are designed to mask price increases. AT&T's claim that actual discount contract prices, as opposed to "rack rates," have declined, also is unconvincing in light of the fact that BOC Phase II contract prices have risen above price cap levels, or are now below price cap levels only because of merger conditions.

Accordingly, the Commission may move forward in this proceeding to implement interim or permanent relief, based on previously established principles and previous approaches.

Sincerely,

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Patrick J. Donovan
Philip J. Macres

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360 Networks (USA), Inc.
ATX Communications, Inc.
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11 U.S. GENERAL ACCOUNTABILITY OFFICE, REPORT TO THE TO THE CHAIRMAN., COMMITTEE ON GOVERNMENT REFORM, HOUSE OF REPRESENTATIVES - TELECOMMUNICATIONS, "FCC NEEDS TO IMPROVE ITS ABILITY TO MONITOR AND DETERMINE THE EXTENT OF COMPETITION IN DEDICATED ACCESS SERVICES (November 2006) 13.

12 AT&T Supplemental Reply Comments, n. 64.

13 AT&T Supplemental Reply Comments 27.

14 AT&T Supplemental Reply Comments n. 52.

Deltacom, Inc.
Lightyear Network Solutions, LLC.
McLeodUSA Telecommunications
Services, Inc.
Mpower Communications Corp. d/b/a
TelePacific Communications
Penn Telecom, Inc.
RCN Telecom Services, Inc.
SAVVIS, INC.
U.S. TelePacific Corp. d/b/a
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